CATERPILLAR®

Caterpillar Inc.

100 NE Adams Street
Peoria, Illinois 61629

June 22, 2009

The Honorable Mike Crapo
United States Senate
Washington D.C. 20510

Dear Senator Crapo:

Thank you for your letter dated June 18th, 2009, requesting the input of Caterpillar Inc. on pending legislation concerning regulation of Over-the-Counter Derivatives. We appreciate the opportunity you have afforded us to comment on these important issues.

Based in Peoria, Illinois, for more than 80 years, Caterpillar Inc. has been making progress possible and driving positive and sustainable change on every continent. With 2008 sales and revenues of $51.324 billion -- driven in part by more than $16 billion in exports from our US-based operations -- Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines and industrial gas turbines. We are also a leading services provider through Caterpillar Financial Services, Caterpillar Remanufacturing Services, Caterpillar Logistics Services and Progress Rail Services. We employ more than 40,000 people across our nearly 300 U.S. locations, and strive to be a positive community leader everywhere we operate.

The following is our response to the three questions you pose.

1. *How does your company use customized over-the-counter derivatives to help stabilize prices and mitigate risk?*

   Caterpillar uses over-the-counter derivatives ("OTC Derivatives") to mitigate risk in three areas:

   a) Interest rates – in order cover risk related to fluctuations in borrowing and lending costs.
   b) Foreign currency – as a global supplier of goods and services, we must cover risk related to fluctuations in currency exchange rates; and
   c) Commodity pricing – to cover risk related to fluctuating prices in raw materials used to produce our products.

   In each of these areas, the purpose of the OTC Derivative contract is to eliminate market-based risk. A simplified example of a commodity forward purchase contract is illustrative.

   Caterpillar has significant exposure to copper price movements through purchases of wire harnesses, electronics and alternators from suppliers.

As the price of copper increases, the cost of these parts also increases. To mitigate this price risk, Caterpillar uses OTC Derivatives called "forward swaps". Caterpillar may, for example, enter into a contract with our counterparty bank to buy X pounds of copper forward for the next Y months. As the price of copper rises, our OTC Derivative Contracts gain in value to offset the higher costs of copper-based parts purchased from suppliers. Upon settlement with the counterparty bank, the gain is settled in cash with no physical exchange of copper. These contracts offer an effective way to manage the embedded cost volatility of parts and components whose price is derived from commodities like copper, aluminum, nickel, zinc, lead, etc.

Similar forward swap arrangements are used to manage foreign exchange exposures and interest rate risks related to short and long-term operational borrowing. In each of these cases, we match our hedges by amount and duration of our anticipated exposure. The ability to customize those amounts and durations with counterparties is key to qualifying for FASB-mandated accounting treatment that allows for stability in SEC-regulated financial reporting.

2. *What are the possible effects of severely restricting access to customized OTC Derivatives on your ability to manage risk and on the prices you charge your customers?*

As explained above, it is critical for Caterpillar to have the flexibility to utilize customized OTC derivative products that allow us to match the underlying exposure we are striving to protect to the specific hedge instrument that best reduces our risk. We match our hedges by amount and duration of our anticipated exposure. Our understanding of currently pending regulation in this area is that it would require a clearing function which would standardize terms like duration and amount. Any standardization of this type would prohibit us from matching exactly the terms of the underlying exposure we are attempting to hedge. This, in turn, would expose us to uncovered risk and introduce needless volatility into our financial results.

Due to hedge accounting requirements, the potential exists for proposed legislation to discourage hedging, resulting in corporate risk taking to avoid earnings volatility. This could be a significant unintended consequence of the proposed legislation.

For example, faced with such a regulatory climate, U.S.-based companies would need to consider one or more of the following courses. First, companies would almost certainly need to add significant cost by implementing processes and otherwise non-value-added back-office functions to comply with mark-to-market and margin requirements. Second, in an environment where companies are asked to undertake greater risk, shareholders would likely expect greater return which could only be achieved by cutting costs or raising revenue elsewhere in the value chain. This could result in a loss of competitive positioning, especially overseas where competitors would not necessarily be saddled with similar requirements. Finally, in the face of such competitive pressures and shareholder expectations, U.S.-based companies may need to explore performing more treasury functions outside of the United States, which would adversely impact American jobs.

3. *What safeguards are in place to ensure that your derivatives portfolio is a tool for hedging risk, rather than a source of risk for your company?*

Caterpillar's derivatives policies are specifically written to ensure we only focus on the management of risks created by our business operations. In the area of foreign currency, for example, we collect foreign currency exposures from worldwide operations and net these exposures to ensure all natural offsets are fully utilized. We only hedge the net portion of our exposure to limit unnecessary risk creation and expense. Derivatives are utilized to hedge these net exposures to protect Caterpillar from the risk of unfavorable movement of a currency. We only enter into foreign currency derivative contracts when we have identified an underlying exposure. Similar policies are in place for commodities and interest rate hedging as well. Caterpillar does not use derivatives to speculate.

Senator, once again we thank you for the opportunity to provide input on this important issue. Caterpillar supports the need for transparent financial reporting and takes our obligations in this area very seriously. We also understand that the recent economic crisis has exposed some areas of the financial system that probably require enhanced regulation. However, as you point out in your request, this is a highly technical issue and poorly crafted legislation could create significant negative and unintended consequences for U.S. manufacturers during the most difficult economic times since the Great Depression.

At Caterpillar, we are very proud of our position as a U.S.-based global industry leader. We employ tens of thousands of Americans in the production of goods and supply of services that are critical not just to the U.S. economy but to the growth of economies around the world. Our business model does not allow for the speculation in derivative contracts, but requires the hedging of certain risks described above.

We believe that the speculation that contributed to the current financial crisis can and should be addressed in a way that does not burden companies like ours who are attempting to responsibly manage risk. We are more than happy to work with members of Congress to further this objective.

Please let us know if you or your staff have any further questions or need more information in this area. Feel free to contact Clay Thompson in our Washington office at (202) 466-0662.

Very truly yours,

Kevin Colgan

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